

Financial Sector Review and Strategy

**Final Report:
Conference Proceedings**

TASK 6 REPORT



Submitted by:
Deloitte Touche Tohmatsu Emerging Markets, Ltd.

Submitted to:
EGAT/EM

Contract No.:
PCE-I-00-99-00008-00, Task Order: 1

February 28, 2003

AGENDA

Financial Sector Annual Review and Strategy: Forum

Wyndham City Center Hotel
Lower Level Ballroom
1143 New Hampshire Avenue
Washington, D.C.
December 11-12, 2002

AGENDA

DAY ONE: ANNUAL REVIEW OF FINANCIAL SECTOR ACTIVITIES

1:00 – 1:15 PM

WELCOME AND OBJECTIVES

John Crihfield, SEGIR-Financial Services Component Manager

IMPLEMENTER PANELS: LESSONS LEARNED

1:15 – 2:00

Banking Systems: When Systems Fail

Moderator: Chris Barltrop, Private Enterprise Office, EGAT Bureau

Presenters: David Cook, Executive Director, Bearing Point (*Bank failures and asset management*)

Laura McQuade, Managing Director, FSVC (*Financial crimes*)

2:00 – 2:45

Financial Sector Supervision and Regulation: Getting Systems to Work

Moderator: Jean Lange, Economic Growth Office, Europe & Eurasia Bureau

Presenters: James Horner, Lori Bittner, Managing Directors, BearingPoint (*Bank supervision*)

Anthony Sinclair, Director, Deloitte Touche Tohmatsu (DTT) (*NBFI supervision*)

2:45 – 3:30

Capital Markets: Building Financial Sector Infrastructure

Moderator: Brad Wallach, Chief, Private Enterprise Office, EGAT Bureau

Presenters: Constantin Abarbieritei, Senior Manager, IBM (formerly PWC)

Charles Seeger, Chairman and CEO, Financial Markets International, Inc. (FMI)

3:30 – 3:45

BREAK

3:45 – 4:30

Pension and MSME Finance: Subsectors of the Financial Markets

Moderator: Denise Lamaute, Senior Pensions Advisor, Office of Poverty Reduction, EGAT Bureau

Presenters: Joe Dougherty, Senior Manager, DTT (*Pensions*)

Charu Adesnik, Manager, DTT (*Pensions*)

Anita Campion, Sr. Manager, Banking and Enterprise Development, Chemonics International (*Micro, small, and medium enterprise finance*)

4:30 – 5:15	Accounting, Disclosure, Corporate Governance: Financial Sector Accountability Moderator: Hugh Haworth, Economic Growth Office, Europe & Eurasia Bureau Presenters: Geoffrey Elkind, Manager, BearingPoint Philip Smith, Development Alternatives Inc. (DAI)
5:15 – 5:30	Wrap-Up John Carihfield

DAY TWO: USAID/EGAT/OEG FINANCIAL SECTOR STRATEGY

8:30 – 9:00 AM	COFFEE/REGISTRATION
9:00 – 9:15	WELCOME AND RECAP Steve Hadley, Director, Office of Economic Growth John Carihfield
9:15 – 9:45	DONOR STRATEGY IN THE FINANCIAL SECTOR Millard Long, Centennial Group, FS Review Team
9:45 – 10:30	REVIEW OF USAID's FS ACTIVITIES Alan Batchelder, EWMI, FS Review Team
10:30 – 10:45	BREAK
10:45 – 11:15	OTHER DONORS' FS TECHNICAL ASSISTANCE ACTIVITIES Gillian Garcia, GGH Garcia Associates, FS Review Team
11:15 – 12:00	IFI and OTHER DONOR OR AGENCY PERSPECTIVES Moderator: Gillian Garcia Panelists: Larry Promisel, co-Chief, FSAP, The World Bank Joe Englehard, Deputy Assistant Secretary, US Treasury Robert Strahota, Assistant Director, International Affairs, US SEC
12:00 – 12:30	Introduction of Keynote Speaker: Jock Conly, DAA, EGAT Bureau Keynote Speaker: Gerard (Jerry) Caprio, Director, Operations and Policy Department, Financial Sector Operations Vice Presidency, The World Bank
12:30 – 1:30	LUNCHEON
1:30 – 2:00	OPTIONS FOR EGAT/OEG Teresa Mastrangelo, Deloitte Touche Tohmatsu
2:00 – 3:15	IMPLEMENTERS' COMMENTS Moderator: Alan Batchelder

3:15-3:30	BREAK
------------------	--------------

3:30 – 4:30

MISSION AND BUREAU COMMENTS**Moderator:** Alan Batchelder**Panelists:** Rebecca Maestri, ANE Bureau
Chuck Mohan, LAC Bureau
Skip Kissinger, EGAT
Ashok Jha, USAID/India
John Wasielewski, DCA
Bryan Kurtz, GDA

4:30 – 5:15

GENERAL DISCUSSION**Moderator:** Alan Batchelder

5:15

WRAP-UP AND ADJOURN**John Crihfield**

PROCEEDINGS

**Financial Sector Annual Review and Strategy: Forum
Workshop Proceedings
December 11, 2002**

Day I – ANNUAL REVIEW OF FINANCIAL SECTOR ACTIVITIES

Welcome and Objectives

Steve Hadley, Director, Office of Economic Growth, EGAT/EM, USAID, welcomed participants to the Forum, acknowledging the contributions of USAID colleagues from Washington and from the field, USAID implementers including SEGIR contractors and FSVC, and special guests from other US Government agencies, the World Bank, and the donor community.

USAID future technical assistance activities must be set in the context of global trends in financial sector development, and build on USAID's competencies and comparative advantages vis-à-vis peers in the donor community. There is little disagreement among the donor community that financial sector reforms are central to achieving reductions in poverty and sustainable economic growth. At the same time, one must not lose sight of the fundamental link between economic development and strong financial markets. Sound financial systems are fundamental to economic growth and poverty reduction, because they channel scarce capital resources to their most productive uses. Financial policymaking is one of the central development issues of our time.

John Crihfield, SEGIR Financial Services Component Manager, EGAT/EM, USAID, also welcomed the participants and provided further details on the agenda for the conference. He made a brief announcement regarding logistics and then introduced Chris Barltrop, moderator of the first panel.

Implementer Panels: Lessons Learned

On the first day, several panelists were asked to address central financial sector issues; present time-tested and proven methods and approaches (lessons learned); and provide an overview of what these lessons mean for USAID financial-sector programs, more generally.

Session 1 – Banking Systems: When Systems Fail

Chris Barltrop, Enterprise Development Financial Sector, EGAT/EM, USAID introduced the first panel entitled "Banking Systems: When Systems Fail". He then introduced David Cooke, Executive Director, BearingPoint, Inc. as the first speaker. Laura McQuade, Managing Director, FSVC was scheduled to present on Financial Crimes, however she was unable to attend the forum.

I. Bank Failures and Asset Management

David Cooke, Executive Director, BearingPoint, Inc. gave a presentation on their experiences in addressing bank failures and asset management projects, stressing the importance of stable banking systems for achieving sustainable economic development. They emphasized the point that unhealthy financial institutions impeded efforts to achieve sustainable growth and prevented other financial sector reforms from fully achieving intended results. The team then discussed their proposed solutions and lessons learned.

Proposed Solutions

In discussing potential solutions for addressing bank failures and asset management, the team highlighted the following issues.

- Cure – Before starting a project, teams should perform an assessment/diagnostic to determine the issues, design a strategy (rehabilitation, liquidation, or sale) that is consistent with government objectives, and then design an implementation program. For Asset Management and Recovery projects, teams should identify the issues involved, prioritize them, and conduct a market assessment to determine potential strategies then develop an implementation plan.
- Climate – The team emphasized the importance of a deposit insurance program. In order for the financial sector to be successful, bank depositors, creditors and investors need to have confidence in the market. Creditors should be aware of their rights and the market should be focused on competition and discipline. In establishing a deposit insurance program, teams should focus on: strategic design, coverage and funding, governance and management, organization and operations and focused development of the functional areas involved.
- Support functions such as public education, MIS/IT, accounting and reporting, and oversight are also important in the development of a strong financial sector.

Lessons Learned

The major lessons learned and highlighted during the presentation included:

- Allow time to build institutional capacity for credible non-repayment resolution
- Provide sufficient hands-on training to allow for testing of the resolution strategies and procedures
- Engage the private sector, as they often know what the barriers to success are
- Get involved early, otherwise assistance ends up as ‘damage control’

Session 2 – Financial Sector Supervision and Regulation: Getting Systems to Work

Jean Lange, Economic Growth Office, Europe & Eurasia Bureau, USAID opened the second session by providing an overview of USAID's work in Financial Sector Supervision and Regulation. Strong effective bank regulatory institutions and the effective enforcement of prudential rules and standards are critical to the development of healthy vibrant banking systems. It is the only way to build confidence in badly damaged banking system and prevent crises from happening or if they happen to manage them well and reduce their impact on the real economy.

Economic reform is about building capacity and changing the way institutions and people behave. If USAID wants to accelerate this process, it is important to understand that banking sector reform, is not just a question of drafting and enacting good laws, or translating US bank supervision manuals, or training supervisors in CAMELS. These are easy to do. It means changing the institutional and organizational environment in which regulators operate. It means building up the credibility and legitimacy of institutions and their staff. USAID can't just provide tools, the experts have to give the institutions and their staff the ability to understand these tools and to use them with knowledge and confidence. It is crucial to get people to act differently and use judgment in a world where in the past judgment only caused one to be in trouble.

Lessons Learned

Before USAID-assisted reform projects there was a lack of understanding of bank supervision in the Eastern European transition countries, -- it was called control. There were excessive regulations not related to the types of risk incurred in the marketplace. Initial reactions of post-communist countries was that excessive regulation was what they were trying to minimize,- intrusion into the private sector. USAID has had to build up credibility among its clients and this was bound to take time; however a few things help along the way:

- The most important thing that USAID does in most of its technical assistance, not just in banking, is programs design. Programs provide the ability to provide a package of solutions, encompassing a wide array of activities.
- The other important point is reliance on resident advisors, supplemented by intermittent experts. These things do set USAID apart from other donors and are critical in the world of banking system reform.
- The specific skills of the advisors are critical. It is not enough to hire someone who has worked at the OCC, or the FDIC, OTS or Fed. The details matter.
- It must be understood that USAID will never get the assessment of the problem right in the initial task order. The project designers and managers are going to be premature in some cases and not ambitious enough in other areas. Flexibility about the technicalities of the assignment, the time frames, the details in the implementation of the workplan is important.

Successful programs in bank supervision must always help the regulators improve their relationship and reputation with the banking community through better communication and common work and training.

Finally, Ms. Lange introduced the speakers, James Horner and Lori Bittner, Managing Directors, BearingPoint, and Tony Sinclair, Director, Financial Sector Development, Deloitte Touche Tohmatsu Emerging Markets, to comment on the differences between bank and non-bank financial sector development. In the banking sector institutions that already exist but don't work properly have to be reformed while in the case of securities markets and pension, have to build institutions primarily from scratch.

I. Bank Supervision

James Horner and Lori Bittner, Managing Directors, BearingPoint, Inc., discussed the importance of supervision for an effective banking sector. An overview of the components of supervision was presented, highlighting the need for regulations, interpretations, policy guidelines and advisory bulletins. Stress was placed on the importance of sustainable capacity building through the institutionalization of a banking supervisory culture. The team then discussed some of the challenges faced in implementing banking supervision programs, such as inadequate legal framework, lack of a compliance culture, inadequate processes and organizational structure, and antiquated information systems. In order to demonstrate lasting positive effects through technical assistance, it is important to address all of these issues. Suggestions for further programs included focusing on the long-term effort and utilizing experiences gained through the implementation of bank supervision programs to jumpstart supervision of non-bank financial institutions.

Lessons Learned

The major lessons learned and highlighted during the presentation included:

- Use international 'best practices' as a guide not as a model to success.
- MUST obtain counterpart trust and 'buy-in'
- Strengthening the financial sector is a long-term endeavor
- Bank supervision impacts political, social and economic platforms
- Successful programs help strengthen both the supervisory agency and the financial sector simultaneously

II. Non-Bank Financial Institutions (NBFI) Regulation and Supervision

Tony Sinclair, Director, Financial Sector Development, Deloitte Touche Tohmatsu Emerging Markets, Ltd. Began the discussion with an overview of the role and importance of NBFIs --- insurance companies, mutual and pension funds, securities markets, credit coops, leasing and financial companies --- in financial markets. NBFIs act as vehicles for savings mobilization, add depth and liquidity to financial markets, provide alternative sources of finance, facilitate resource allocation, and permit the transfer of risk. The importance of NBFIs in the

financial sector is evidenced by the fact that, as economies grow and mature, so too does the role of NBFIs, often with a higher role/level of importance than the banking sector. A regulatory trend over the last several years is to integrate regulation. Broadly, the goals of integrated regulation are to achieve neutrality in regulation among financial institutions, scale the intensity of supervision by the degree of market failure each institution represents, improve the coordination of regulation towards different objectives, and sharpen oversight of financial conglomerates. Integrated regulation can also facilitate achievement of economies of scale, by organizing functions to minimize overlap, duplication and conflicts in regulation.

Lessons Learned

To establish an integrated framework for regulation of NBFIs, it is important to keep in mind that not all financial institutions need to be regulated in the same fashion. The regulator must take into consideration the goals for each NBFI and the necessary oversight required before establishing regulations. The first step is to determine regulatory objectives (i.e., safety/soundness, market conduct, consumer protection, competitiveness, etc.). These objectives should drive the activities and accountability of the regulator. Once objectives are set, various tools can be designed around prudential standards, market conduct, entry requirements, disclosure, etc. Next, regulation is applied, the intensity which should be calibrated depending on the particular industry and level of risk it represents. For example, the intensity of regulation of banks may be much higher than for leasing companies, given that bank failure can have a significant impact on the financial sector. Similarly, the type of supervisory response should be geared to the severity and frequency of misconduct. Intervention options, therefore, should be proportional, and can range from a notice of censure to revocation of license to criminal prosecution, depending on the type of misconduct.

Potential areas for USAID assistance include defining overall regulatory philosophy and key objectives, developing regulatory frameworks for each industry, drafting specific regulations, developing supervisory approach for each industry along with associated guidelines, and designing and delivering training to regulatory and industry professionals.

Session 3 – Capital Markets: Building Financial Sector Infrastructure
--

Brad Wallach, Chief, Enterprise Development and Financial Sector, EGAT/EM, USAID introduced the “Capital Markets: Building Financial Sector Infrastructure” panel, which consisted of two speakers, Constantin Abarbieritei, IBM and Charles Seeger, Financial Markets International, Inc.

I. Capital Markets I

Constantin Abarbieritei, Senior Manager, IBM Business Consulting Services, Inc. provided an overview of some of the challenges faced in implementing capital markets projects in transitioning economies. He then discussed global trends in capital markets and how they affect developing markets. In his concluding remarks, Mr. Abarbieritei presented lessons learned and possible interventions going forward.

The major challenges highlighted in the presentation were the low volumes of financial transactions in the markets, high transaction costs, lack of regulatory transparency and enforcement, and uncertain sustainability. USAID has attempted to address these issues by providing assistance for legal reform, development of regulatory capacity, establishment of trading platforms, and the formation of self-regulatory organizations. The results of each of these programs has been mixed.

Some of the major global trends affecting the developing capital markets include the liberalization of cross border investment flows, consolidation of financial services firms, expansion of financial instruments, harmonization of disclosure requirements, and active corporate governance pressures to implement higher standards. Going forward, financial markets reform should focus on building regulatory frameworks, helping to develop industry skills, and implementing international standards and best practices. For capital markets development, it is important to have coordination among donors in the implementation of policies initiatives and direct financing of capital for private sector development.

Lessons Learned

The major lessons learned and highlighted during the presentation included:

- Legal reform is imperative and should be coordinated with the other donors to help focus the government
- In building regulatory capacity, it is important to leverage local champions
- Progress for the development of self regulatory organizations in “early stages” market is slow and therefore, donor patience is required

II. Capital Markets II

Charles Seeger, Chairman and CEO, Financial Markets International, Inc. centered his discussion on the basic tenants for successful development of capital markets. His main view was that, although there are some unique factors in each environment, there is only one money culture. Successful capital markets honor the money culture and should follow certain basics principles, such as accurate disclosure, reliable delivery vs. payment systems, and effective corporate governance. Countries who continue to lag in their economic development because they choose to argue for their “uniqueness”, make this choice because they deliberately choose not to embrace such reform. Mr. Seeger’s suggestion to donors for countries who choose not to reform is to stop providing aid and let them fail. Although the money culture should be the same for each country, Mr. Seeger argues that the delivery of assistance for reform to the money culture may need to be tailored slightly to contextualize the information. while the fundamentals should remain the same.

Lessons Learned

The major lessons learned and highlighted during the presentation included:

- Prepare: Pursue the best no matter the difficulty, only performance speaks
- Certain fundamentals must be in place, followed, and enforced if capital markets functions are to succeed
- Reform takes time and dedication
- Crucial to gain complete “buy-in” with the local citizens for successful implementation

Session 4 – Pensions and MSME Finance: Sub sectors of Financial Markets

Denise Lamaute, Senior Pensions Advisor, Office of Poverty Reduction, EGAT Bureau, USAID introduced the “Pensions and MSME Finance: Sub sectors of Financial Markets” panel. The speakers on Pensions were Joe Dougherty, Senior Manager and Charu Adesnik, Manager, Financial Sector Development, Deloitte Touche Tohmatsu Emerging Markets, Ltd. Anita Campion, Senior Manager, Banking and Enterprise Development, Chemonics International presented on micro, small and medium enterprise finance.

I. Pension Reform: Opportunities and Challenges for USAID

Joe Dougherty, Senior Manager, and Charu Adesnik, Manager, Financial Sector Development, Deloitte Touche Tohmatsu Emerging Markets, Ltd. began the presentation with a review of the central objective of mandatory pension systems: the avoidance of future social costs associated with a large number of elderly poor. To achieve this objective, a national pension system should ensure adequate retirement income to system participants, achieve full coverage of the appropriate target group, maintain long-term financial sustainability, and support (or at least not hinder) general economic growth. Demographic drivers, such as an aging population combined with lower birth rates, along with other factors such as poorly designed, regulated or managed pension program can cause severe problems, including crowding out private savings and investment, straining government budgets, causing civil unrest or redistributing wealth from the poor to the rich. On the other hand, an effectively designed pension system can, in fact, facilitate significant GDP growth as was demonstrated in the sample projections from Thailand.

The general trend in pension reform is pulling away from the Pillar I system towards a multi-pillar system, contributions instead of defined benefits and allows for individual choice in investment decisions. A multi-pillar system also allows for more private management of assets (instead of government control), and provides new ways to blend pillars and provide minimum guarantees. However, it should be stressed that the balance among pillars should reflect the economic and political realities of the specific country – there is no “one size fits all” approach.

Lessons Learned

Many client countries are in need of assistance in pension reform, which USAID can provide through grant assistance. Each solution must be tailored to specific country needs and impacts, requires careful consideration and appropriate interventions, as well as proactive public outreach and education to ensure political support.

Potential intervention options for USAID were discussed. At the outset, evaluations can be conducted to assess current pension systems and determine the needs for intervention. These initial assessments are low cost, can be completed quickly and can provide some ‘insurance’ that subsequent interventions will be targeted, appropriately sequenced, efficient and, ultimately, more successful. Potential areas for more dedicated assistance include policy design, reform of existing systems, governance, investment management and MIS/IT systems.

II. Micro, Small, and Medium Enterprise Lending

Anita Champion, Senior Manager, Banking and Enterprise Development, Chemonics International, discussed the importance of Micro, Small and Medium Enterprise (MSME) Lending for economic growth. In the past, USAID IQC’s have been highly focused on banking and microfinance. However, SMEs represent a large underserved market and offer the most employment and growth potential. Lessons from both banking and microfinance can be applied to the MSME sector. Two approaches to MSME finance that were highlighted were: (1) downscaling, working with commercial banks to offer smaller loans through a guarantee facility, and (2) upscaling, working with a microfinance institution to offer larger loans. The Uganda SPEED project was highlighted as a successful program in this area.

Lessons Learned

The major lessons learned and highlighted during the presentation were:

- Include an enabling environment component to promote and advocate a positive regulatory environment
- Reduce risks - assess character, analyze cash flow of business and households, use collateral and co-signature guarantees
- Know your market
- Develop MSMEs holistically, link to business development services, competitiveness and sub sector strategies
- Initially, focus on the domestic markets – it is hard for small enterprises to leap to export markets

Session 5 – Accounting, Disclosure, Corporate Governance: Financial Sector Accountability

Hugh Haworth, Economic Growth Office, Europe & Eurasia Bureau, USAID introduced Session 5 “Accounting, Disclosure, Corporate Governance: Financial Sector Accountability.” Philip Smith and Jay Dyer, Development Alternatives, Inc., presented first followed by Geoffrey Elkind, BearingPoint, Inc.

I. Accounting Reform and Corporate Governance

Philip Smith, Chief of Party for Accounting Reform in Russia, Development Alternatives International focused his discussion on the case of Accounting Reform in Russia, which consisted of two tasks: (1) providing support to the reporting committee, the technical accounting and training committee of the IACC, and (2) organizing and conducting accounting pilot projects in selected commercial banks. He presented the project strategy, outputs and tangible results.

Lessons Learned

Based on the experience in Russia and five other countries, Mr. Smith highlighted the lessons learned as:

- Immediately, push for laws on current and future IAS compliant accounting
- Achieve full ‘buy-in’ from counterparts, by sharing TOR, work plans, etc
- Consider funding salaries of IAS specialists for the Central Bank
- Consider TA to universities to add IAS to the curriculum
- Conduct training in corporate governance for senior managers, line managers and internal auditors within the central banks
- Include international and local accounting firms and tax inspection personnel in the training process

Jay Dyer, Senior Development Specialist, Development Alternatives Inc., centered his discussion on corporate governance issues. He presented two case studies, The Agricultural Bank in Mongolia and the National Microfinance Bank in Tanzania, and discussed the results of each. The core objectives were to turn around the banks to restore financial soundness, provide financial services to underserved “missing” markets and to prepare the banks to operate independently. The teams focused on increasing accountability in bank management through modifying the corporate culture, preventing political influence, changing the composition of the board of directors and senior management, increasing transparency and analyzing and revising current policies and procedures.

II. Accounting, Disclosure and Corporate Governance

Geffrey Elkind, Manager, BearingPoint, Inc., provided an overview of some of the financial sector challenges faced in most emerging markets, which included: no accountability in the legal framework, no corporate governance culture, resistance of local custom and practice to reform, and poor or non-existent enforcement. He then emphasized the importance of a longer term development horizon; standardized diagnostic approaches; targeted frameworks to manage gaps, inefficiencies, and conflicts; and targeted capacity building and training. Suggestions for future programs included building on the World Bank ROSC diagnostic approach, development of best practice codes, legal/regulatory/judicial reforms, training and certification programs.

Lessons Learned

The major lessons learned and highlighted during the presentation included:

- Use “bright-line” concepts, approaches and strategies
- Good governance starts at the top
- Anti-corruption efforts are not optimal
- Perceptions matter – enforcement is key
- Effectively empower and educate stakeholders
- Sustainable reform – buy-in and capacity building

Overview of US Patriot Act

William Langford, Senior Counsel for Financial Crimes, Office of the Assistance General Counsel, US Treasury, The US Patriot Act and especially its potential influence on USAID and its programs was debated in the end of the first day. Langford focused his discussion on several of the issues that the US Treasury Department is facing in communicating the logistics involved in the implementation of the Act to banks, both in the US and abroad. He was interested in discussing ways that USAID and the implementers could also pass along the information regarding the Patriot Act to international banks. If there are any questions or if anyone needed more information, Mr. Langford encouraged people to contact him at william.langford@do.treas.gov.

As the seminar had gone slightly over time, **John Carihfield, SEGIR Financial Services Component Manager, USAID** made a few closing comments, thanking the moderators, speakers, and participants. He then concluded the first day of the seminar.

**Financial Sector Annual Review and Strategy: Forum
Workshop Proceedings
December 12, 2002**

DAY 2 – USAID/EGAT/EG FINANCIAL SECTOR STRATEGY
--

On day two of the conference, the team from Deloitte Touche Tohmatsu discussed the preliminary results of the work on the Financial Sector Review and Strategy. Comments on these findings from USAID colleagues, major implementers, and partner donors and agencies in the development community followed.

Welcome and Recap

Steve Hadley, Director, Office of Economic Growth, EGAT Bureau, USAID, opened the second day of the seminar by welcoming all participants and providing an overview of the agenda for the day. He then commented on the new challenges in financial sector development that will affect USAID's programs, which included redirection of human and financial resources, new mechanisms for funding development assistance, the decrease in funding for Central and Eastern European countries and the reorganization that resulted in the formation of the Economic Growth, Agriculture and Trade (EGAT) Bureau.

The focus for the second day of the conference were the preliminary results of the work of the team from Deloitte Touche Tohmatsu on the Financial Sector Review and Strategy. Then, the comments of USAID colleagues, major implementers, and partner donors and agencies in the development community followed. The strategy discussed is a work-in-progress, and the views and comments of the participants were used to help make this work more responsive to financial sector developmental needs.

There are new challenges in financial sector development that will affect USAID's programs. First, the Agency's human and financial resources are being redirected to reflect the Bush Administration's priorities. Second, new mechanisms for funding development assistance, such as the Global Development Alliance, are starting to be incorporated into Mission interventions.¹ Third, funding for the Central and Eastern Europe region, which has received the bulk of USAID's financial sector funds in recent years, is being scaled back. Fourth, USAID has undergone a substantial reorganization that resulted in the formation of the Economic Growth, Agriculture and Trade (EGAT) Bureau.

EGAT management have a mandate to provide technical leadership and field support in all economic growth areas to USAID programs worldwide. This includes work in financial sector development. Accordingly, the Office of Economic Growth, EGAT Bureau engaged the Deloitte team to undertake a series of targeted studies on the evolution of global financial markets to assist in the development of strategic options for OEG's role and activities for the next ten years.

¹ The Deloitte team did not undertake a review of the Global Development Alliance.

John Carihfield, SEGIR Financial Services Component Manager, USAID, also welcomed the participants to the second day of the seminar, introduced the speakers and provided further details on the agenda for the conference.

The speakers for the second day of the conference included Alan Batchelder, Millard Long, Gillian Garcia, and Teresa Mastrangelo. Mr. Batchelder is a senior macroeconomist with over 40 years experience in the field of economics. He has been a professor of economics at the University level, a Ford Foundation visiting professor in Nigeria, a Senior Economist and consultant with Elliot Berg and a Senior Economist at the U.S. Agency for International Development where he was a Mission Chief Economist, and one of the leading senior economists focused on international policy reform issues and institutional economics.

Mr. Millard Long is widely regarded as one of the leading financial economists in the world specializing in policy analysis and advice. During his more than 25-year career in high-level policy formulation at the national and international levels, he has provided advice to senior policy makers on financial sector reforms and restructuring in some 30 countries, including China, Korea, Indonesia, Hungary, Russia and Turkey in the aftermath of the Asian Financial Crisis.

Ms. Garcia is a former Senior Economist with the International Monetary Fund, specializing in crisis management, financial sector assessments, financial modernization and financial sector regulation/supervision. Based upon her work with the Financial Stability Forum as well as her time at the IMF, she brings considerable knowledge of the reforms for international financial architecture with an emphasis on the banking industry. She was formerly with the Senate Committee on Banking, the Government Accounting Office and the US Federal Reserve. She has taught at several prominent US Universities on financial sector topics.

Teresa Mastrangelo is a well-known colleague of the SEGIR Financial Sector contractors present at the Forum and has been serving USAID for nearly 16 years. Ms. Mastrangelo is a Director in Deloitte Touche Tohmatsu Emerging Markets (Deloitte Emerging Markets), specializing in financial institutions. Until last year, she served as the SEGIR FS Project Manager for Deloitte. She has supported financial sector development in South America, Asia, Central Europe, and Russia and the CIS. In her role as team leader, she has been responsible for compiling the findings of her team members and presenting those to USAID.

After his presentation of the speakers, Mr. Carihfield passed the floor to the Millard Long, as the first speaker.

Donor Strategies in the Financial Sector

Millard Long, FS Review Team Member, Centennial Group, presented the Deloitte team's finding for the Task 1 report, which involved performing an evaluation of the international financial architecture. Mr. Long presented trends to introduce the financial sector topology and provide a common understanding of how it might assist USAID missions to program financial sector activities.

The Conference at Bretton Woods in 1944 established the post-war International Financial Architecture. Under the system, the prices of the major currencies were to be pegged, but adjustable if significant misalignments developed. The United States defined its currency in terms of gold and other countries defined theirs in terms of dollars. Trade was to be open, but there were to be controls on capital movements. The IMF was to monitor the rules of the system and would make loans to countries needing short-term liquidity to defend their exchange rates.

In the last 50 years, there have been many minor, and three major, adjustments to the system. In the late 1960s-early 1970s, the United States trade deficit grew too large to be financed. Too many dollar liabilities were generated. In the late 1960s, the SDR was created as an additional reserve currency, and in the early 1970s, the major currencies moved to floating rates with a concomitant fall in the value of the dollar. The second change came in the early 1980s with the Latin American debt crisis. Private creditors were forced to write down the value of their loans and the IMF and World Bank took on a new role, that of financing policy changes in developing countries to enable them to adjust following a major crisis. The third adjustment came in the late 1990s, this time in response to crises in some of the most important emerging markets. Instead of ex-post adjustment, the present changes in the International Financial Architecture are designed to reduce the incidence of crisis and to lessen its severity.

The recent adjustments have produced substantial improvements. With regard to domestic financial systems, reforms are underway. In the last decade the countries of Central Europe have been building financial systems which are increasingly operating on market principles. The systems are not perfect, but the remaining problems appear to be manageable. Several countries in Latin America and East Asia have made major reforms in the wake of crises. India and Turkey have recently taken steps to improve their systems. Many developing countries' financial markets are now more open to foreign participation. Exchange rate systems are moving from soft pegs toward systems that are more robust. Slowly but surely the quality of information in developing countries is also improving. Few developing countries have adopted the IAS in full but some are incorporating important aspects, in particular, the accounts of financial intermediaries are becoming more transparent with better treatment of non-performing loans and unpaid interest. These are substantial achievements; still all would agree that much remains to be done. And it is in these areas that USAID through its technical assistance programs has much to contribute.

In recent years, there have been reforms of the International Financial Institutions. There has been considerable improvement in surveillance, that is, gathering information and assessing country systems to see whether they meet codes and standards of best practice and remain free

from the dangers of crisis. But there is still controversy over the role and practices of the IMF as the lender of last resort. Does the IMF's approach reduce or increase the incidence and severity of crisis? Should only those countries that pre-qualify have access to crisis funding and are the IMF's ex post loan conditions the medicine for recovery, or invasive and unhelpful? Should crisis lending be bigger to stem contagion or smaller to prevent moral hazard; how high should the interest rate be on such loans and how long should be the term? We have pointed out that the IMF has made adjustments in both its approach and lending terms, but the changes made in this area seem marginal rather than radical.

In addition to the practices of the developing countries and the International Financial Institutions, the third objective has been to change the behavior of the providers of capital. Stabilizing capital flows is seen as an important action for reducing crises. Here too there has been substantial improvement, more in the mix of funding than in changing the behavior of capital providers. In value terms, foreign direct investment has become predominant and flows are quite stable. But bond and bank finance is still quite volatile. Can these aspects of finance be made more stable and can private lenders be made to bear more of the cost of crises? "Changes in the international financial system has been driven largely by the ever more rapid growth of private international capital flows, which first overwhelmed the Bretton Woods fixed exchange rate system, and, since the 1980s, has had especially strong effects on the emerging market countries. The evolving system poses several challenges, including the need to find ways of working constructively with the private sector in both crisis prevention and crisis response." (Fischer, 2000, 2). Because of the fear that actions taken to reduce volatility might also decrease the overall flow of capital, there has been reluctance to introducing mandatory regulations, such as collective action clauses in bond contracts. In most crises provisioners of all forms of capital have lost money. Still, to a degree, there has been some bailing out. The management of ex-post restructuring is still determined on a case-by-case basis, though the IMF has now proposed a new approach to sovereign debt restructuring, akin to domestic bankruptcy proceedings. However, private sector involvement is the area in which least has been accomplished to date.

Crisis seems to be an inherent flaw of capitalism. Painful though it is, countries experiencing the disease do recover. The disease has not one cause, but many. We should continue our efforts to find and ameliorate those causes but without the conceit that crisis will ever be eliminated.

Review of USAID's Financial Sector Activities

Alan Batchelder, FS Review Team Member, East West Management Institute, provided an overview of the report based upon Task 3 and 4 of the scope of work, which summarized their findings in the review of USAID's Financial Sector activities from 1988-2001. In the discussion, reference was made to the charts contained within the report, which showed greater details on the breakdown of spending between regions, countries, income levels and technical areas.

Between 1988 and 2001, USAID spent just over \$1.2 billion on financial sector development assistance through 761 individual interventions in some 87 client nations. The number of interventions initiated in a given year has fluctuated from a low of 14 (in 1988) to a high of 101 (in 1996), while the total expenditure on financial sector development assistance has also

fluctuated. On average, about 54 new projects were initiated each year with an average cost of about \$1.6 million per project. However, the cost per project has tended to increase over the past 14 years, from an average of \$337,000 in 1988-90 to an average of \$1.75 million per project in 1999-2001. It is not clear whether the changes in the level of new FSD authorizations each year reflect changes in the overall USAID budget or changes in the level of priority of FSD work relative to other areas. Nor is it clear whether the increase in average cost per project reflects a wider trend within USAID or is specific to financial sector assistance projects.

Well over half of the 14-year total of \$1.2 billion went to countries in Europe and Eurasia (E&E), while the rest was spent more-or-less evenly among other regions, as seen in the chart on the following page. This division should not be surprising given the high priority that post-Communist economies have received in the last decade. Within Europe and Eurasia, the funds were spread among 27 countries. It is interesting to note that, according to the World Bank's 1998 income criteria, 38% of the money was spent in low income countries, while 46% was spent in lower middle-income countries and 10% was spent in upper middle income countries.

The team analyzed the quantitative data across two additional dimensions – type of beneficiary institution and type of assistance. First, projects across all sub-sectors were categorized according to the nature of the beneficiary – over the period of analysis 18% of USAID's FSD projects by number and 14% by value were aimed exclusively at regulatory agencies, while 43% of projects and 31% of value were aimed exclusively at market participants, such as banks, NBFIs, stock markets, pension funds, etc. 36% of the projects representing 55% of the total value of FSD authorizations involved both regulators and regulated entities, while a small number of projects (29) representing a negligible percentage of total funds was directed within USAID, for internal training, conferences and other capacity building activities related to financial sector development. Interesting, the percentage of the number of projects *within each subsector* targeted to regulators v. regulated institutions v. both has varied widely. For example, 61% of housing finance projects, 72% of micro, SME and rural finance projects and 77% of other NBFI projects were targeted exclusively to market institutions, with no component of the projects addressing regulators' needs.

It is also interesting – and encouraging – to note that over half of all FSD assistance projects included an institution building component while 40% included training. On the other hand, only 6% of projects included a public relations component and less than 2% of projects addressed the enforcement of regulations – even of the 136 projects that were aimed exclusively at regulatory agencies, only 5 included any work on enforcement.

Finally, the team cross-referenced the ten types of assistance shown above with the seven sub-sectors discussed earlier. While the allocation of assistance types was broadly similar across sub-sectors, there were several interesting anomalies, all of which occurred in the 'pensions and insurance' and 'micro, rural and SME finance' sub-sectors. First, keeping in mind the earlier finding that pensions and insurance accounted for only 5% of USAID's FSD projects over the past 14 years, it should not be surprising to see that 50% of these projects involved an evaluation/assessment component, against an average of only 37% for all sub-sectors – this would seem a prudent response to USAID's relative lack of experience in this sub-sector. While only 4% of all projects involved privatization work, 19% of pensions and insurance projects

included privatization – this probably reflects the trend towards ‘multi-pillar’ pension schemes combined perhaps with the privatization of state-owned insurance providers in transitional economies. Finally, 17% of pensions and insurance projects involved public relations, against a cross-sub-sector average of just 6%. This probably reflects the fact that changes in mandatory pension schemes affect the general population, while changes in areas such as commercial bank regulation or securities markets have a more limited – or at least less obvious – impact on the population.

Only 7% of projects in the micro, rural and SME finance sub-sector included legislative components, only 7% included transparency and only 11% included regulation and supervision. The averages across all sub-sectors for these three assistance types are 14%, 20% and 16% respectively, as seen in the chart at right. In other words, USAID’s allocation of resources suggests that that these three closely related areas are only roughly half as important for micro, rural and SME finance as they are for other sub-sectors. This has probably been true for most of the past fourteen years – emphasis was correctly placed on simply ensuring that financing was made available to microenterprises, farmers and SMEs – but the situation is now clearly changing. In many countries, for example, microfinance institutions (MFIs) cannot collect deposits because they cannot comply with the regulatory requirements for deposit-taking institutions. This inhibits their ability to grow and provide better services to their clients. Moreover, MFIs and SME lending institutions often cannot attract commercial investment because they lack transparency and a stable regulatory/legal framework under which to operate, which also inhibits the growth of the sector. USAID’s Office of Microenterprise Development has recently issued a new Indefinite Quantity Contract (IQC) called AMAP – Accelerated Microenterprise Assistance Project – including an “Enabling Environment” component that can be used to provide technical assistance in building appropriate legal and regulatory frameworks for MFIs, which would also improve transparency.

Office of Emerging Markets

Since 1988, USAID’s Office of Emerging Markets (EGAT/EM) funded 401 projects worth \$243 million. Using the same analyses to EM’s portfolio as was used for USAID overall, we found that EM’s financial sector development activities – which account for about 20% of the total funding, but more than half of the projects – followed broadly similar patterns as those of the Agency as a whole. The division of funds and projects among regions, for example, was almost exactly the same. However, the following exceptions to this general pattern stand out:

- *EM-initiated FSD assistance projects favored least-developed countries more:* 53% of EM’s funding went to lower middle income countries and only 5% went to upper middle income countries as compared to 46% and 10%, respectively, for USAID as a whole. Moreover, 50% of EM’s projects by value were in those countries in the lowest stage of financial sector development, while USAID as a whole spent only 40% of its money in these countries.
- *EM focused more on commercial banking and less on other NBFIs and multi-sector projects:* 33% of EM’s FSD funding was allocated to the banking sub-sector as opposed to 20% of overall USAID funding; conversely, EM spent 3% of its funds on other NBFIs and 17% on

multi-sector projects while USAID as a whole spent 10% and 28% on these sub-sectors, respectively. EM spending on other sub-sectors was in line with USAID overall.

- *EM focused more on evaluation/assessment and less on institution building:* In terms of types of assistance, 57% of EM projects included an evaluation/assessment component, while only 37% of USAID's 761 projects did so. However, only 31% of EM projects involved institution building while 52% of USAID projects did. This divergence might reflect the fact that EM, as a centralized support office, bears greater responsibility for evaluating client country needs and assessing project results, while missions are better placed to offer direct capacity-building assistance to market institutions and regulators.
- *EM has played a leading role in pension and insurance and micro, rural and SME finance:* While EM accounts for only 20% of all USAID FSD spending, 45% of funding for pensions and insurance and 31% of funding for micro, rural and SME finance passed through EM.

Over the past fourteen years, a great deal of assistance has taken place through a number of global or regional contracting mechanisms. In the early 1990s, the Europe and Eurasia (E&E) Bureau launched the Omnibus I and II IQCs. Similarly, EM's predecessor office managed the Financial Sector Development Program I and II from 1988 to 1998 and the IRIS and CAER contracts. In mid-1997, EM introduced five IQCs under the umbrella of SEGIR program (Supporting Economic Growth through Institutional Reform), one of which was for Financial Services. Since SEGIR's inception, some \$196 million in financial sector development assistance has been authorized through its five IQCs, representing 61% of the total for all sectors. Interestingly, of 116 financial sector projects authorized under SEGIR, only 68 were contracted through the Financial Services component. The remaining 48 projects were contracted through a combination of the other four components.

Based on our findings, it is clear that there are a number of opportunities for USAID to heighten its impact on global financial sector development, and it is clear that USAID's central offices like EGAT/EG/EDFS and E&E are well placed to pursue these opportunities and play a stronger coordinating role in the Agency's financial sector development, if they are given sufficient resources to do so.

Other Donors' Financial Sector Technical Assistance Activities

Gillian Garcia, FS Review Team Member, GGH Garcia Associates, provided a summary of the Task 2 report, which provided an assessment of what donors do in terms of strengthening, safeguarding, standardizing and regulating reform of the international financial system as it affects the financial system of developing countries. A detailed breakdown showing the involvement of the players in financial sector development can be found in the report.

Ms. Garcia began by providing an overview of the twenty-six relevant domestic and international players in financial sector development that were reviewed in the assessment. Some challenges ensued in data gathering because these donors currently do not have any internal central databases containing information on financial or technical assistance to financial systems. The

team focused on gathering whatever information they could through annual reports, websites, email requests and telephone discussions.

Financial surveillance encompasses macroeconomic policies and conditions, data collection and dissemination, development of standards and codes, and monitoring of standards and codes. FSAP's and ROSC's are conducted under this area. Ms. Garcia highlighted the different players in this area, along with the extent of their involvement. She then focused on the Financial Sector Assessment (FSAPs) and Review of Standards and Codes (ROSCs) programs. One of the major issues with the FSAP/ROSC is that there are heavy demands on World Bank and IMF staff. The assessments show that there is a great need for pre and post FSAP technical assistance that the World Bank and IMF are not in a position to provide. USAID and other bilateral donors can fill the technical assistance gap if they are allowed access to the FSAP results.

Technical Assistance

There are many players offering similar types of assistance in many of the same countries. The importance of financial services technical assistance is often under-appreciated. Little is known about the efficacy of financial sector technical assistance since it is rarely evaluated.

USAID is a significant provider of financial sector technical assistance. However, it needs more resources than its current allocation of 2.5%. Its all-grant policy is attractive to recipients. Specifically, USAID can help fill the gaps that FSAPs reveal on its own or in cooperation with other donors, through mechanisms such as the FIRST initiative. USAID should do more systematic evaluations and should also follow a planned topology for choosing countries for providing aid.

IFI and Other Donor or Agency Perspectives

Gillian Garcia served as the moderator for the "IFI and Other Donor or Agency Perspectives" panel. Participants included Larry Promisel, co-Chair of the Bank/Fund Financial Sector Liaison Committee, World Bank, Joe Englehard, US Treasury, and Robert Strahota, Assistant Director, International Affairs, US SEC.

Larry Promisel, Co-Chair of the Bank/Fund Financial Sector Liaison Committee, World Bank provided an overview of the Financial Sector Assessment Program (FSAP). The FSAP, a joint IMF and World Bank effort introduced in May 1999, aims to increase the effectiveness of efforts to promote the soundness of financial systems in member countries. Supported by experts from a range of national agencies and standard-setting bodies, work under the program seeks to identify the strengths and vulnerabilities of a country's financial system; to determine how key sources of risk are being managed; to ascertain the sector's developmental and technical assistance needs; and to help prioritize policy responses. Currently, 70 countries have voluntarily participated in the FSAPs.

Detailed assessments of observance of relevant financial sector standards and codes gave rise to Reports on Observance of Standards and Codes (ROSCs) as a by-product. To date, 300 ROSC modules have been completed. These assessments are intended as guides for the authorities.

The FIRST Initiative was established as a mechanism to fund technical assistance needs, as highlighted in the FSAPs and ROSCs.

Joe Englehard, Deputy Assistant Secretary of Treasury for Trade and Investment Policy, US Treasury spoke about the Financial Sector Led Growth Initiative (FSLGI), which emphasizes the importance of increasing depth, liquidity and efficiency of the domestic financial sector to achieve growth and sustainability in developing countries. Studies show that liberalizing and deepening the financial services sector, in conjunction with strong legal, supervisory and regulatory institutions, is associated with higher rates of growth through channeling investment to the most productive uses, enhancing capital accumulation, increasing the productivity of investment and minimizing transaction costs through trading of risk, monitoring managers and mobilizing savings. Liberalization means to open domestic markets to FDI in financial services and according foreign and domestic firms equal treatment. This is distinct to opening the capital account. The level of foreign ownership in a financial sector can contribute to crisis avoidance. Foreign bank entry can strengthen the financial sector and increase stability. In fact, foreign entry has been associated with system wide improvements in the quality of regulation and disclosure. The steps to liberalization are to remove any impediments to an open, transparent financial sector and to strengthen supervision or reform regulations to create the right incentives for a growth oriented sector. There are several benefits to liberalization, as were demonstrated in the presentation through the example of the entry of foreign financial service providers in the US. These include: promoting innovations, strengthening the securities market, promoting domestic competitiveness, increasing allocation efficiencies, and providing cost savings to the consumers. The measurements to determine a successful financial sector include quantitative measures, greater access to credit for consumers and businesses and commitments at the WTO. The presentation ended with a comparison of different countries across many factors, indicating that successful markets were more liberalized.

Robert Strahota, Assistant Director, International Affairs, US SEC, explored the trends of global convergence of the financial markets and presented the importance of increasing information disclosure, corporate governance, and financial reporting. The implementation of the FSAP program is geared towards the second component. USAID could direct its efforts towards removing the obstacle to integration, specifically in the markets of the CEE/NIS region. He discussed the importance of securities market development through training of security regulators and stockbrokers. Look at the licensing program for broker/dealers before integration to ensure consistency. In regulation, consolidated supervision across the financial sector is the trend. This makes sense in the small countries because there are not a lot of private organizations. A concern is for banks and NBFIs to be regulated uniformly. A template idea is good; it can help to improve existing markets but not to set up new ones like, for example, in Kosovo, Albania, etc.

Financial reporting is good overall. There are six principles currently highlighted in the FSAPs for financial reporting and they will add a seventh: understandability of reports. Countries are to look to IAS. In the Cancun meeting, the discussion centered on providing oversight of independent auditors, creating a public oversight body.

Keynote Session

Jock Conly, DAA, EGAT Bureau, USAID introduced the Keynote Speaker, Jerry Caprio. He began by commenting on the importance of financial sector reforms in achieving reductions on poverty and sustainable economic growth, supporting one of Mr. Caprio's main arguments. Jerry Caprio serves as the Manager of Financial Sector Research in the World Bank's Development Research Group. He has written extensively on financial sector policy, financial reform and monetary policy. His current research addresses financial crises, and the links between financial sector regulation and the performance of financial institutions. His presentation provides an overview of the importance of addressing financial policy decisions in the central development challenges of the new century.

Gerard (Jerry) Caprio, Director, Operations and Policy Department, Financial Sector Operations Vice Presidency, The World Bank provided an overview of the book, Financing For Growth. As the title, Finance for Growth: Policy Choices in a Volatile World, suggests, we try to identify policies that both maximize the growth potential from finance as well as minimizing the down side, namely, the threat of financial crisis. This book attempts to explain how these policies will work. The bottom line is that the book is urging a rethinking of government's role in finance, highlighting first what governments need to do, such as building the legal and regulatory foundations of the financial sector; what they need to do better, which is working with markets and harnessing incentives; and what they need to do less of, that is, owning banks outright or unduly restricting foreign entry. We also focus on how technology is changing what policymakers can do and how we are moving to a world of finance without frontiers. What matters for growth and poverty alleviation is access to financial services--not who supplies them. The advice in this volume is not deduced from some theory, but rather, from a review of empirical research in recent years, much of it conducted inside the Bank but definitely not all of it, and this is with very large datasets of countries working with anywhere between 60 and 160 countries, depending on the data. So in short, we try to show that finance matters.

Getting finance right we think will contribute to poverty reduction by delivering to all services that are needed to generate growth and absorb the volatility that all economies get at one time or another. I will try to sum up just four messages. First, on what governments need to do--well-functioning financial markets, especially those that are going to supply financial services and credit to small and medium-sized firms, need legal and regulatory underpinnings to boost the reliability of information and ensure that contracts are going to be enforced by a court of law.

Turning next to what governments need to do better, above all, we think that governments have to harness incentives. We think that policy needs to take account of local conditions in emerging markets. The more volatile environment facing developing countries requires that authorities focus on the incentives that are affecting the actors in the system--the owners of the banks themselves, the markets that can monitor them, and the bank supervisors themselves.

Turning now to an area in which we think there is room for less government involvement, although there is much that government needs to do more of, this list does not include owning banks.

We argue that we are quickly moving to a world of finance without frontiers, and countries must decide which financial services they will buy and which they will build at home. As was mentioned earlier, what matters for growth is not who provides the services but the access to those services. Seen against the background of the global financial systems, developing countries are very small indeed. An open financial system is, however, vulnerable to external shocks, but a closed system means that the poor residents there are far more vulnerable to different events at home, such as when the prices of their products fall, as well as policy mismanagement.

Above all, even for countries not ready to open up completely to capital flows, opening up to foreign financial institutions, however politically sensitive it was or still is in countries, has helped strengthen many emerging markets in risk management, credit appraisal, and other dimensions. In finance, government's role is to ensure that the financial sector infrastructure is sufficiently developed and that participants have the incentives to work well together for desired outcomes, which is the prudent supply of financial services to all members of society.

Options for EGAT/EG/EDFS

Teresa Mastrangelo, Director, Deloitte Touche Tohmatsu Emerging Markets, Ltd. gave a few short comments on the options for EGAT/EG, but deferred her allocated presentation time to the implementers, as the previous presentations had run over. However, a summary of her presentation is included in these preceedings.

Ms. Mastrangelo summarized the overall project, describing the findings of the Deloitte team related to each of the four initial tasks undertaken as foundation for the recommendations made in the Options paper. She then described the options for the Office of Economic Growth, with emphasis on the potential global programs to meet EGAT/EG's mandate of providing technical leadership and field mission support for financial sector development activities. Several of these opportunities were mentioned in previous discussions.

1. USAID should use the publicly available output from World Bank/IMF Financial Sector APs as a point of departure for designing its own TA initiatives in some cases. EG might disseminate FSAP reports and work with Missions to design projects— perhaps by developing sample Terms of Reference.
2. USAID might also use the available FSAP results as a part of assessing the impact of its own projects. EG might provide a focal point for standardizing this assessment methodology and applying it across relevant Missions.

3. FSAP-oriented TA activities might lend themselves particularly well to public-private partnerships. For example, twinning arrangements with US banks might be established to help developing country banks learn how to comply with higher regulatory standards. EG could support Missions by helping to facilitate these partnerships.
4. Limited impact evaluations and an apparently random fluctuation of assistance across sub-sectors – together suggest that EG might support Missions by designing and helping implement a standard impact evaluation methodology that can be used as an input into the priority-setting process.
5. USAID should continue to cooperate closely with other donors and take on areas of assistance in which it has a relative advantage.
6. Within USAID, EG can play a strong role in initiating and coordinating regional (cross-national) projects.
7. EG's resources should be used to expand its knowledge management role. For example, as part of knowledge management, staff should update and maintain the database constructed as a part of this study, which lists USAID financial sector projects from 1988 to 2001. EG may use program funds for this work and as well as for enhancement of their current website. A dedicated knowledge manager might be hired.

EG asked Deloitte to identify global trends or issues in financial sector development that might affect the direction of USAID's programs in the near future to supplement the findings of the first four tasks. It is clearly important to understand the issues that USAID's projects might address in future in order to determine how EG can best support those projects. The majority of USAID's financial sector work will continue to be designed and implemented at the country level, based upon specific country strategies developed by the Missions. EG has an important role to play in supporting the Missions' work and helping to ensure the ultimate success of their projects. Specifically, EG has two objectives with regard to supporting the Agency's financial sector development work:

1. *Field Support*
2. *Technical Leadership in New and Existing Programs*

EG might consider initiating global programs that are consistent with its technical leadership mandate. EG might work with Missions to implement pilot projects that address country-specific issues related to the key financial sector trends listed earlier. These projects would likely represent new approaches for USAID, would likely require specialized expertise that might not be available within a given Mission, and could require some research and conceptual work to be performed in advance of a project to identify common problems across countries and develop tools to be used in solving them. OEG is particularly well placed to launch such pilot projects because it can take on greater uncertainty than Missions – assuming its mandate explicitly includes innovation and experimentation with new project designs.

In considering the list of global trends and the possible interventions, above, we suggest below some illustrative projects which meet the criteria for a global program and which OEG might undertake that would be meaningful to many USAID partner countries over the next decade:

- *Financial regulation and supervision.* Based upon an analysis of gaps in assistance conducted to date, OEG could suggest to Missions the scope and content projects, such as consolidated regulation and supervision, surveillance, and enforcement as well as steps countries can take to support the development and reform of the IFA.
- *Compliance with international supervisory standards.* There is a need for extensive training and internships to upgrade supervisory capacity to meet international standards such as the Basle Core Principles or Basle II requirements, which can be done on a broad scale rather than by individual countries. OEG could employ implementers to design and deliver this training, sharing the costs of participation with Missions and with beneficiaries.
- *Rating agency/service development.* Under the new Basle capital adequacy framework, there is likely to be a significant increase in the demand for rating services, providing an additional target of opportunity for USAID work.
- *Regionalization of securities markets.* We propose OEG undertake an initiative to determine how to harmonize or regionalize regulation, supervision, technology, and operations. A technical assistance gap analysis or analysis of the pre-conditions for harmonization could then be used to guide Mission development of statements of work.
- *Prevention of money laundering, terrorist financing, and financial crimes and related law enforcement* are key issues coming to the forefront and most Missions have not integrated these issues into financial sector programs. In parallel with the new World Bank initiative and those of the US Government, in collaboration with interagency partners, OEG could lead the Agency in tackling these issues on a global or regional basis.
- *Expanding markets through e-finance:* Again, this is an area in which OEG could take a technical leadership role in analyzing current research on e-finance, identifying potential interventions and then, assisting Missions to design programs through which they could assist financial institutions to introduce technologies that lower operating costs and that make it possible to provide financial services more widely.
- *Expanding access to finance for SMEs and for the poor:* USAID has funded several large SME finance activities, the impact of which are still unknown. It is now critical for OEG to evaluate and synthesize the successes and failures of these SME projects for future project design.
- *New financial instruments development,* which results in better diversification of products and improved financial intermediation, is another innovative area for USAID.

Ms. Mastrangelo concluded by stating that the scope of EG's role going forward and what level of the activities it may undertake, depends on its resources. The team presented four scenarios to EGAT/EG management to consider. Of those, a scenario in which there are about 4 financial sector specialists in a dedicated unit with about \$2 million of program funds would seem consistent with the objectives of the USAID reorganization to improve support to the Missions.

If, on the other hand, there is a net decrease in financial sector expertise, USAID may have limited its opportunity to solidify the accomplishments made to date.

Implementers' Comments

Alan Batchelder, EWMI, FS Review Team, served as the moderator for a panel of implementers who were invited to comment on the research and findings of the Deloitte team. Speakers from Chemonics, IBM Consulting, Development Alternatives, Inc., BearingPoint and FMI provided their inputs. The comments below of the various implementers are categorized by general theme.

Developing incentives and investing in success:

One implementer noted that the nature of USAID programs has been focused on building capacity and culture. The implementer stressed that developing appropriate incentives are critical to the success of USAID-sponsored programs, and, therefore, should be an area of focus for USAID going forward.

Several implementers suggested that USAID “invest in success”. To this end, they recommended that the Agency develop evaluation criteria and then measure programs against these criteria so that they know what works, what doesn’t work, and, in each case, why. Measuring success is important, but tricky. Therefore, USAID should ensure that it is using the right measurement tools. In this way, USAID can better determine when to continue to invest in an existing program, when to exit an existing program, and when to invest or not invest in a new program or country. If a project is yielding positive results, USAID should leverage this and move forward to the next phase of associated reforms. By doing this, USAID can radiate out. For example, in central banks, once they have addressed bank supervision issues, they could potentially look at the “softer side” of banking issues, such as human resources.

Knowledge Management:

Several implementers noted that knowledge management is another important area where USAID should focus its efforts. Intellectual capital is built but is not disseminated within USAID. This was, in fact, confirmed by the Deloitte team’s findings. USAID needs to be able to leverage information gathered from past projects --- successful and unsuccessful --- and should be organized to gather, process, and disseminate knowledge of best practices and lessons learned for other programs.

SME, Microfinance and E-finance:

One implementer noted their appreciation of the emphasis on globalization and the discussion of E-Finance. The implementer added that they would have liked to have seen more examples of SME finance, which is an intrinsic part of the financial sector. The implementer stressed that new product development is important, although also noted that it is equally important to ensure that new product development is market driven, and not a one-product-fits-all approach. The implementer agreed with the emphasis on public relations, noting that as it is important to sell vision, and suggested that missions should build in more time for public relations, in order to explain proposed reforms, communicate the need for reforms, and build ownership, commitment,

and support for reforms. Without ownership and commitment, no program, regardless of its merits, can be successful. Finally, the implementer supported the idea of more project evaluations, and stressed the importance of setting up an appropriate monitoring and evaluation framework right from the start. Building on the idea of ownership and commitment, this implementer also suggested that consensus building should be considered for a standard performance indicator within the project evaluation framework.

New product development:

Several implementers expressed their support for research project and believed it was a good undertaking for the OEG. One implementer agreed with the new product development ideas and mentioned that past funding in the CEE region had led to successful patterns and themes, which could be used in developing the new products.

Policy coherence, risk management and evaluations:

One implementer analyzed the paper from a policy standpoint and noted that he did not feel that regional initiatives are necessary. The evaluations of USAID programs currently stress ‘lessons learned’, whereas he felt they should be more year-end and mid-year evaluations to determine whether programs are on-track. In this way, if programs are not on track, interventions can be undertaken to set them back on course during the project, rather than waiting until projects end when it is too late to take remedial action. Along these lines, he suggested that USAID should emphasize risk management. He also noted that policy coherence should drive decision making. Further, he suggested that USAID should design a menu of development topology of activities for different countries at different stages of development, in order to build on success, lessons learned, and best practices gained from experiences in other countries at similar stages of development.

SEGIR mechanisms:

All implementers supported the premise behind the SEGIR mechanisms. They noted that these mechanisms enable targeted, rapid, and streamlined responses to key issues. One implementer noted that these mechanisms are in need of better management and administration.

Mission and Bureau Comments

Alan Batchelder, EWMI, FS Review Team, also served as the moderator for a panel of mission and bureau representatives who were invited to comment on the research and findings of the Deloitte team. The following USAID representatives provided comments: Chuck Mohan, LAC Bureau; John Wasilewski, Development Credit Authority (DCA); Skip Kissinger, EGAT; and, Brian Kurz, Global Development Alliance (GDA).

Chuck Mohan, LAC Bureau, USAID, stated that he felt that the recommendations by USAID should be much more firm. USAID needs to focus on making intermediation work better. The beneficiaries need to understand better what USAID does. This is important for successful project implementation by USAID.

John Wasilewski, Development Credit Authority discussed the importance of the Development Credit Authority (DCA) in furthering the objectives of USAID. DCA is the legislative authority that permits USAID to issue partial loan guarantees to private lenders to achieve the economic development objectives in the Foreign Assistance Act of 1961, as amended (FAA). DCA also authorizes USAID to make direct loans. DCA guarantees require true private sector risk-sharing where the USAID share of a lender's risk does not exceed 50 percent (except as otherwise approved by the Credit Review Board (CRB)). DCA permits USAID to offer a mixture of grant and credit assistance in settings where USAID is seeking more disciplined and sustainable assistance relationships. Under DCA, Missions/Operating Units have the flexibility to fund their activities with 100 percent grants, or they can transfer some of their funds to the DCA Account and in effect purchase the right to issue full faith and credit USG guarantees or loans having a value far in excess of the sums transferred.

Skip Kissinger, EGAT Bureau commented on the importance of the peer review process and felt that the conference was very beneficial. He felt that one of the biggest challenges faced by USAID was getting all of the information from the meeting to the missions, since they are the ones who form the projects.

Brian Kurtz, Global Development Alliance, provided a brief overview of the Global Development Alliance (GDA). GDA is USAID's response to the new reality of development assistance that recognizes that flows between the developed world and the developing world have changed. The Global Development Alliance serves as a catalyst to mobilize ideas, efforts, and resources of the public sector, the private sector and non-governmental organizations in support of shared objectives.

General Discussion

Teresa Mastrangelo summarized the major comments from the various panelists on the financial sector strategy report and responded briefly to them.

1. **Limitations of the data from the Financial Sector Assessment Program (FSAPs).** Ms. Mastrangelo acknowledged that much of the output of the FSAP program is confidential, but that nevertheless, missions could benefit from a systematic collection and analysis of the publicly available data in the absence of regular assessments being conducted by the Missions themselves. With declining financial sector resources in USAID Missions, there is a greater need for knowledge to be provided to them from a group such as EGAT/EG.
2. **SME and Microfinance.** One contractor disagreed with the statement made that “SME finance is not intrinsic to the stability or performance of the financial sector.” Ms. Mastrangelo explained that from the perspective of the FS Review team it was necessary to delineate financial sector development from overall private sector development and economic growth for the purposes of their study, even though there may be overlap. From the team’s perspective, SME finance is a separate discipline and the results sought in microfinance projects and SME finance projects are not the development of the financial sector, but rather, are income generation and employment growth.

3. **Policy coherence.** One commenter made the statement that what was needed from EGAT/EG was a coherent financial sector policy which set targets for Missions worldwide and that, perhaps, was a fifth scenario to the four presented in the report. Ms. Mastrangelo agreed that policy coherence was critical and commented that the expression “policy coherence,” was perhaps a more appropriate way to refer to the suggestions in Scenarios B and C.
4. **Non-humanitarian assistance.** Another commenter had made the point that the list of global programs made in the report was perhaps too sophisticated for the needs of some of USAID partner countries. Ms. Mastrangelo pointed out that in fact, the role of EGAT/EG was to be ‘out-in-front’ and provide technical leadership, and, accordingly, should more likely propose sophisticated solutions to financial sector development problems. Nevertheless, she did agree with the vital role that USAID plays in providing non-humanitarian assistance, particularly in post-conflict countries, and committed to revision of the report accordingly.

Wrap-up and Adjourn

John Carihfield, SEGIR Financial Services Component Manager, USAID, wrapped up the conference by thanking all of the moderators, speakers, and participants. He thanked the Deloitte team for a job well done and encourage everyone to take what had been learned from the conference to further improve the programs offered by USAID.

ATTENDEES

**LIST OF ATTENDEES
FINANCIAL SECTOR REVIEW AND STRATEGY**

**Wyndham City Center
Lower level ballroom
1143 New Hampshire Ave.
Washington, DC**

NAME	POSITION OR TITLE	ENTITY
USAID MISSION PERSONNEL		
Haikanush Bagratunyan hbagraturyan@usaid.gov	Project Management Specialist	ARMENIA/EREO
Thomas Morris TMorris@usaid.gov	SUPVY GEN	ARMENIA/ERE
Kenneth J. Borghese, Ph.D. kborghese@usaid.gov	International Economist	PPC/DCO
Quan Dinh qdinh2@yahoo.com		INDONESIA/ECG
Ashok Jha ajha@usaid.gov		INDIA/PDEG
USAID/WASHINGTON PERSONNEL		
John Crihfield jcrihfield@usaid.gov	SEGIR FS Component Manager	EGAT/EG/EDS
Stephen Hadley shadley@usaid.gov	Director, Office of Economic Growth	EGAT/EG
Skip Kissinger skissinger@usaid.gov	SEGIR Manager	EGAT/EG
Erin Nicholson enicholson@usaid.gov	New Entry Professional, Private Enterprise	EGAT/EG
Brad Wallach bwallach@usaid.gov	Chief, Private Enterprise Office	EGAT/EG/EDFS
Jean Lange JLange@usaid.gov	Team Leader	E&E/EG/FSP
Rebecca Maestri rmaestri@usaid.gov	Deputy Team Leader	ANE/SPO/SPPM
Mark Gellerson mgellerson@usaid.gov	Chief, Economic Policy Office	EGAT/EG/EPG
Stephen Eastham seastham@usaid.gov	Senior Capital Markets Advisor	E&E/EG/FSP
Hugh Haworth hhaworth@usaid.gov	Senior Capital Markets Advisor	E&E/EG/FSP
Denise Lamaute dlamaute@usaid.gov	Senior Pensions Advisor	EGAT/EG/ILE
Jacqueline Schafer jschafer@usaid.gov	Deputy Assistant Administrator	EGAT/AA

NAME	POSITION OR TITLE	ENTITY
Sandra Goshgarian SGoshgarian@usaid.gov	General Business Specialist	EGAT/GDA
Elizabeth Range erange@usaid.gov		EGAT/HCD
John Wasielewski jwasielewski@usaid.gov	Supvy General Business Specialist	EGAT/DC
Francesca Nelson FNelson@usaid.gov	Albania/ Romania Desk Officer	EGAT/ EG
Larry Paulson LPaulson@usaid.gov	Agricultural Development Officer	EGAT/AFS/AEMD
David L. Painter DPainter@usaid.gov	Director of the Office of Urban Programs	EGAT/ENV/UP
Bryan H. Kurtz BKurtz@usaid.gov	Special Projects Coordinator	GDA
Jeanne Balcom JBalcom@usaid.gov		USAID
Scott E. Lampman slampman@usaid.gov	Deputy Director EAI/TFCA Secretariat	EGAT/ENV
Georgia Sambunaris GSambunaris@usaid.gov	International Trade Specialist	EGAT/EG
Yumiko Ikuta YIkuta@usaid.gov	Private Enterprise Officer- Nigeria	RCSA/OPI
Kathleen Wu KWu@usaid.gov	Chief Risk Officer	EGAT/DC
Suzanne Nolte Saunders SSaunders@usaid.gov		EGAT/EG
Fred Witthans FWitthans@usaid.gov	Grants Manager	DCHA/FFP/POD
Joe Lessert jlessert@usaid.gov	Private Enterprise Officer	EGAT/EG
Jason A. Girard jgirard@usaid.gov		EGAT/UP
Rajiv Rastogi RRastogi@usaid.gov	Manager, Power Restructuring & Privatization Energy & Infrastructure Division	EGAT/EIT
Liza Valenzuela lvalenzuela@usaid.gov	Deputy Director Microenterprise Development Division	EGAT/EG
Art Warman AWarman@usaid.gov	Senior Privatization Advisor/ SEGIR Privatization Component Manager Private Sector Team	EGAT/EG/EDFS

NAME	POSITION OR TITLE	ENTITY
Art Westneat AWestneat@usaid.gov	Private Sector Advisor Agency	AFR/SD
Lena Heron lheron@usaid.gov		EGAT/AFS/AEMD
Eleni Pelican		USAID
Judith E. Payne jpayne@afr-sd.org	e-Commerce, e-Business USAID	EGAT/EIT/IT
CONTRACTORS		
Deloitte Touche Tohmatsu		
Teresa Mastrangelo tmastrangelo@deloitte.com	Director	Deloitte Emerging Markets
Veronica Gilbert vegilbert@deloitte.com	Senior Manager	Deloitte Emerging Markets
Anthony Sinclair ansinclair@deloitte.com	Director	Deloitte Emerging Markets
Joe Dougherty jodougherty@deloitte.com	Senior Manager	Deloitte Emerging Markets
Charu Adesnik caadesnik@deloitte.com	Manager	Deloitte Emerging Markets
The Aries Group		
John Shoraka	Vice President, Projects	The Aries Group
Anthony Shoraka	Vice President	The Aries Group
P. Michael Laub	Practice Leader, Banking	The Aries Group
Kenneth Newman	Practice Leader, Capital Market Development	The Aries Group
DAI		
Dan Hogan	Director of New Business Development; Finance, Banking and Enterprise Group	DAI
John Jepsen	Senior Associate	DAI
Marina Krivoshlykova	Associate	DAI
Phil Smith	Chief of Party	DAI
John Cann	Principal Development Specialist	DAI
Jay Dyer	Senior Development Specialist	DAI
Carrie Averch	Associate Development Specialist	DAI
BearingPoint		
Jimmy Horner		BearingPoint
Lori Bittner		BearingPoint
David Cooke		BearingPoint
Jack Biggs		BearingPoint

NAME	POSITION OR TITLE	ENTITY
Jim Rives		BearingPoint
Ken Cahill		BearingPoint
Patrick Bryski		BearingPoint
Geoff Elkind		BearingPoint
Norman Baxter		BearingPoint
Chemonics		
Ron Ivey	Director, Banking and Enterprise Development	Chemonics
Michael McNulty	FS IQC Project Administrator	Chemonics
Mikael Hook	FS IQC Assistant Project Administrator	Chemonics
Anita Campion ACampion@Chemonics.net	FS IQC Project Manager	Chemonics
FMI		
Charles M. Seeger	Chairman	FMI
Robert D. Bond	President	FMI
Peter M. Levine plevine@fmi-inc.net	Vice President	FMI
Anthony J. McMahon amcmahon@fmi-inc.net	Research Associate	FMI
Other Guests		
Millard Long Millardlong2000@yahoo.com		Centennial Group Inc.
Gillian Garcia ggrgarcia@aol.com		GGH Garcia Associates
Alan Batchelder anbatch@charter.net		East-West Management Institute, Inc.
Brian Hannon Bhannon@ewmi.com		East-West Management Institute, Inc.
Adrian Hewryk		East-West Management Institute, Inc.
Gerard Caprio Gcaprio@worldbank.org	Director, Financial Sector Development	The World Bank
Amar Bhattacharya	Senior Advisor, Poverty Reduction and Economic Mgmt Network	The World Bank
Marlene Breen BreenMU@state.gov		U.S. Department of State
Sean Jones JonesSM5@state.gov	Office of Development Finance (EB/IFD/ODF)	U.S. Department of State
Joe Engelhard Joe.Engelhard@do.treas.gov	Deputy Assistant Secretary Trade & Investment Policy	Dept. of Treasury

NAME	POSITION OR TITLE	ENTITY
Bill McFadden bill.mcfadden@do.treas.gov		Dept. of Treasury
Steve Joachim	Senior Vice President Market Operations	NASD
Joe Riley	Associate International Department	NASD
Steven Polansky Steven.Polansky@NASD.com	Director International Department	NASD
Antonia Bodnar		ADB
Gary Lazor		Nathans
Christa Lachenmayr		Nathans
Don Pressley		Booz Allen Hamilton
Michele Laird		Abt Associates, Inc.
Howard Kane		Abt Associates, Inc.
Willie Mae McDowell wm.mcdowell@Triumph-tech.com	Director of Marketing and Sales	Triumph Technologies, Inc.
Lena S. Brown	Financial Consultant	Triumph Technologies, Inc.
John Deary		Financial Services Volunteer Corps
Chad Kilbourne		Financial Services Volunteer Corps
Constantin Abarbieritei	Senior Manager	IBM
Jay Kalotra JKalotra@ibtci.com	President and CEO	IBTCI
Robert van Heest	Director, Business Dev't	IBTCI
Bob Otto botto@carana.com	Director	CARANA
Aaron Chassey AChassy@padcoinc.com		PADCO